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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. [redacted] 120

BEN BIMBERG & CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Brief in Support of Petition for Writ of Certiorari.

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CITATIONS.

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Opinion Below.

The judgment sought to be reviewed is that of the United States Circuit Court of Appeals for the Second Circuit, entered on March 7, 1942, reported at 126 F. (2d) 412, affirming the memorandum decision of the United States Board of Tax Appeals of April 21, 1941.

Jurisdiction.

The jurisdiction of this court is invoked under the Act of February 13, 1925 (C. 229, 43 Stat. 938) amending the Judicial Code, Section 240; Title 28 U. S. C. A. Section 347.

Statement of the Case.

To avoid undue repetition, counsel merely refers the Honorable Court to the Summary Statement of the Matter Involved in the petition for writ of certiorari.

Specification of Errors.

I.

The court below erred in holding that before the statute of limitations has run preventing a reassessment of the earlier return (1935) the Commissioner may at his pleasure either reassess the original tax or include the refund in the income for the later year (1936).

II.

The court below erred in holding that the taxpayer in order to obtain a reassessment of the earlier return when the statute of limitations is no bar must bring the refund to the Commissioner's notice as soon as it is received.

III.

The court below erred in failing to hold that the taxpayer gave the Commissioner an adequate opportunity before the statute of limitations had run to readjust the earlier return.

IV.

The court below erred in failing to hold that a taxpayer who gives the Commissioner an adequate opportunity before the statute of limitations has run to readjust the earlier return may compel the Commissioner to reassess the original tax.

V.

The court below erred in affirming the decision of the United States Board of Tax Appeals which decision also imposed a 25% delinquency penalty on the taxpayer.

Summary of Argument.

It is the petitioner's position that the Commissioner should have readjusted the original deduction in the 1935 tax return on account of the refund of taxes illegally imposed since the correction of that return was not prevented by the statute of limitations.

The petitioner gave the Commissioner an adequate opportunity to readjust the 1935 return before the statute of limitations had run and such should suffice on the issue of notice to the Commissioner.

The Commissioner, before the statute of limitations has run, should not at his pleasure be permitted to either reassess the original tax or include the refund in the income for the later year.

ARGUMENT.

POINT I.

The Commissioner should have readjusted the original deduction in the 1935 tax return since the correction of that return was not prevented by the statute of limitations.

The rule of law as laid down by the courts is that where a tax which was deducted from income is refunded in a subsequent year due to the unconstitutionality of the statute under which the tax is imposed, the Commissioner

should readjust the earlier return and include the refund therein when correction of that return is not prevented by the statute of limitations.

Inland Products Co. v. *Blair,* 31 F. (2d) 867 (C. C. A. 4, 1929) (1 U. S. T. C. Par. 390);
Bergan v. *Commissioner,* 80 F. (2d) 89 (C. C. A. 2, 1935);
Leach v. *Commissioner,* 50 F. (2d) 371 (C. C. A. 1, 1931) (C. C. H. Par. 9416);
Bohemian Breweries, Inc. v. *United States,* 27 F. Supp. 588, 89 Ct. Cl. 57 (1939);
E. B. Elliott Co. v. *Commissioner,* 45 B. T. A. 82 (1941).

In *Inland Products Co.* v. *Blair, supra,* Judge Parker pointed out that the whole question involved was one of correction of mistake and to readjust the returns for the earlier years by eliminating the deduction in question would place both parties to the mistake exactly where they would have been if it had not occurred.

Accord: Mim. 3958, C. B. XI-2, p. 33 (July-December, 1932).

The rationale of the aforesaid rule of law is that the deduction claimed turns out to have been improper and illegal, and since the mistake has been discovered within the time alloted for correction, the return in which the deduction was claimed should be readjusted.

In *J. A. Dougherty's Sons, Inc.* v. *Commissioner,* 121 F. (2d) 700 (1941) (41-2 U. S. T. C. Par. 9562) the issue was whether deductions were properly taken in the prior years. The court permitted a deduction from gross income of accruals made for taxes imposed by a state statute subsequently declared unconstitutional. The provo-

cation for reaching such a result was very great and the Third Circuit, speaking through Judge Jones, stated, p. 10, 346:

> "The particular hardship to the taxpayer * * * grows out of the fact that the Pennsylvania Tax Act was declared unconstitutional in a year subsequent to the taxable years in which the accruals were made, while in the meantime the federal tax on undistributed profits had been enacted and had become effective in the year 1936. Hence, the taxpayer's necessary accrual on its books of the Pennsylvania floor taxes for the respective years rendered the sums so accrued unavailable for dividend distribution in the taxable years. The effect, therefore, of the Commissioner's ultimate disallowance of the taxpayer's deductions for the accrued 1936 and 1937 floor taxes is to restore earnings, *pro tanto*, to those years and at once render them subject to the federal undistributed profits tax * * *. There is evidence in the case * * * that, except for the Pennsylvania floor tax, dividends would have been declared and paid by the taxpayer in 1936 and 1937 to an extent at least equal to the amount of the floor taxes accrued for those years. The taxpayer argues that, in such event, it would never have been subject to surtaxes on undistributed profits for 1936 and 1937, had it been free to distribute its earnings without thought for accruals on account of the Pennsylvania floor taxes."

Furthermore, the *Dougherty* case did not proceed on the basis of correction of a mistake but according to Judge Learned Hand seemed to rely on some language in *Chicot County Drainage* v. *Baxter State Bank*, 308 U.

S. 371, to the effect that an unconstitutional tax is not quite a nullity, but lives in Limbo, as it were, until the court puts an end to it (R. 35).

Contra:

Norton v. *Shelby County,* 118 U. S. 425, 442;
Chicago, Indianapolis & Louisville R. R. Co. v. *Hackett,* 228 U. S. 559, 566;
Louisville Gas & Electric Co. v. *Coleman,* 277 U. S. 32;
Frost v. *Corporation Commission of Oklahoma,* 278 U. S. 515.

Judge Learned Hand, speaking for the court below, said: "* * * we are disposed to consider the decision as not generally contradicting the power of the Commissioner to cancel such a deduction" (R. 35).

The case of *Commissioner* v. *Central United National Bank,* 99 F. (2d) 568 (C. C. A. 6) (38—2 U. S. T. C. Par. 9562) was recognized by Judge Hicks therein as different from the *Inland Products Co.,* the *Leach* and *Bergan* cases, *supra,* on which cases petitioner here relies, for unlike those cases, the *Central United National Bank* case involved a tax deducted which finally turned out to be lawful. Judge Hicks stated, p. 10, 677:

> "In the *Blair* case there was an erroneous assessment and payment of taxes, and the court held that the taxpayer could not take deductions therefor after the illegal taxes had been refunded.
>
> "The question in the *Leach* and *Bergan* cases was similar to that in the *Blair* case. It has but little analogy to the issue here."

The Treasury Department's rulings since 1920 support the contention of the petitioner that the Commis-

sioner should readjust the original deduction on account of refunds of taxes illegally assessed and collected, where correction of the prior return is not prevented by the statute of limitations.

In O. D. 741, C. B. 3, p. 115 (July-December, 1920) the ruling held that excess customs duties, which were paid during the years 1915, 1916, and 1917 and for which a refund was received during the year 1919, were amounts which had been erroneously deducted in computing net income for the years 1915, 1916, and 1917, respectively, rather than an amount representing income for the year 1919.

In Mim. 3958, C. B. XI-2, p. 33 (July-December, 1932) the Treasury Department approved of the *Inland Products Co.* case, *supra,* and further stated that legal and proper collections of customs duties and taxes should be distinguished from those illegally or improperly made. In the case of the former, any refund thereof does not constitute the correction of a mistake because no mistake has been made (viz: the drawback provisions of the law where the importer pays the customs duties, but later secures a refund by showing that the goods imported on which the duties were paid have gone into a manufactured article which was later exported). The Treasury concluded that refunds of customs duties or taxes, the collection of which was legally or properly made, should be treated as income for the year in which refunded.

The Treasury in Mim. 4564, C. B. 1937-1, p. 93, stated:

> " * * * in the case of a refund in any year of customs duties or taxes illegally assessed and collected which have been taken as deductions in Federal income tax returns for a prior year, if the taxable year in which the deduction was taken is closed

by the expiration of the period of limitations for the making of an additional assessment of income tax * * *, the refund shall be treated as income for the taxable year in which it was made.

"Refunds of customs duties and taxes legally collected which have been taken as deductions in Federal income tax returns for a prior year should continue to be treated in all cases as income for the taxable year in which the refund is made * * *."

(See: 1942 P-H pp. 7173-4, par. 7301.)

The situation in the processing tax reimbursement cases is like that where a tax has been illegally collected or paid under mistake in one year, and refunded in a subsequent year. The processing tax reimbursement cases should logically adhere to the same doctrine and in the instance where the statute of limitations is no bar the subsequent refund or reimbursements should be adjusted as of the year when the tax was paid or deduction taken, in order to properly reflect the income for that year.

The Board of Tax Appeals relied mainly on the decisions of *North American Oil Consolidated* v. *Burnet*, 282 U. S. 417, and *Burnet* v. *Sanford & Brooks*, 282 U. S. 359, as supporting its determination that the reimbursements received should have been accrued as income for 1936. However, the general rules set forth in those cases have no application to the circumstances involved in the instant case. Those decisions did not involve a refund in a subsequent year of an illegally collected tax when a correction of the earlier return was still possible and the Circuit Court of Appeals below apparently recognized this distinction. Furthermore, the Board itself has in a number of recent cases similar to the present case recognized that the rules set forth in the *Burnet* and *North American* cases, *supra*, do not apply.

See:

Sanford Cotton Mills, Inc. v. *Commissioner,* 42 B. T. A. 190 (1940), (N. A.) 1940-2 C. B. 14 and G. C. M. 22404, 1940-2 C. B. 204, I. T. 3430, 1940-2 C. B. 205 (No Appeal);

Cartex Mills, Inc. v. *Commissioner,* 42 B. T. A. 894 (1940), (N. A.) 1940-2 C. B. 9;

Smith Packing Co. v. *Commissioner,* 42 B. T. A. 1054 (1940);

Cannon Valley Milling Co. v. *Commissioner,* 44 B. T. A. 763 (1941), (N. A.) 1941 P-H par. 66,367, App. (C) July 14, 1941 (C. C. A. 8);

Security Flour Mills Co. v. *Commissioner,* 45 B. T. A. 671 (1941), (N. A.) 1942 P-H par. 66,094, App. (T) Feb. 11, 1942 (C. C. A. 10), App. (C) Mar. 26, 1942 (C. C. A. 10).

In *Smith Packing Co., supra,* taxpayer, shortly after the processing tax under the Agricultural Adjustment Act was invalidated on January 6, 1936, received from a bank an amount of money which had been held in escrow for taxpayer's account in 1935, pending the outcome of litigation concerning the validity of the processing tax. The Board held that the Commissioner was in error in including the amount in question as taxable income for 1936.

In *Cannon Valley Milling Co., supra,* taxpayer, a first processor, during its fiscal year ended in 1937, reimbursed its vendees for processing taxes included in the price of wheat products sold to them in May and June 1935. The Board held that in order to clearly reflect the taxpayer's income for the fiscal year ended June 30, 1935, such reimbursements were deductible in computing its net income for that year since they represented payments relating to the claims on 1935 sales and were not related to sales made in 1937.

The petitioner's position is as follows: If it is proper as a matter of practical accounting for a vendor to accrue the amounts to be paid to the vendees under "Charlotte clauses" as an expense or setoff against sales for the year 1935, it would follow as a necessary corollary that petitioner, as vendee, should accrue these reimbursements as income or a reduction of costs in the same year Where both the first processor and its vendee are on the accrual basis, it would be illogical as well as improper accounting practice to hold that the obligation of the vendor to make payment was accruable in 1935 but that the right of receipt of the vendee could not be accrued in the year 1935.

See also:

Ada Milling Co. v. *Commissioner,* 45 B. T. A. Memorandum Opinion, Docket No. 100,466, 1941 P-H par. 65,018, reported in full 1941 P-H B. T. A. Memo. Service, par. 41,502;

Athens Roller Mills, Inc. v. *Commissioner,* 46 B. T. A. No. 135, 1942 C. C. H. par. 7,507 (April 28, 1942);

Flour Finance Co. v. *Commissioner,* 46 B. T. A. Memorandum Opinion, Docket No. 105,206, 1942 C. C. H. par. 7,502-C (April 17, 1942).

POINT II.

The Commissioner was given an adequate opportunity to readjust the 1935 return before the statute of limitations had run, which suffices on the issue of notice.

It is the petitioner's contention that a taxpayer is entitled to a readjustment of the earlier return in the case of a refund or reimbursement in a subsequent year on ac-

count of the unconstitutionality of a tax statute if the earlier year is not outlawed by the statute of limitations.

On the question of notice to the Commissioner, the petitioner agrees with Judge Learned Hand's statement, concerning a refund; namely, that the Commissioner should not on refund of the tax be automatically charged with the duty of scrutinizing the earlier return to see whether a deduction has been made and whether the statutory period has expired for reassessment of the income if a deduction was taken (R. 36). However, the petitioner submits Judge Learned Hand's further statement that to secure a possible reassessment the taxpayer must bring the refund to the Commissioner's notice as soon as he receives it (R. 36), is erroneous, harsh and unsupported by authority.

It is further submitted that the correct approach to the problem of notice to the Commissioner is the following: It should be considered sufficient notice if the taxpayer gives the Commissioner an adequate opportunity to reassess the earlier return before the statute of limitations has prevented such reassessment. If the Commissioner then deliberately or unintentionally permits the statute to run, he should not thereafter be allowed to raise the defense that since a reassessment of the earlier return is barred by the statutory period, the taxpayer must be deemed to have received taxable income in the refund year. The proposed rule is more equitable than the one suggested by Judge Hand.

Moreover, the view adopted by Judge Hand would react most harshly on the taxpayer who frequently is not instantly aware of his right to seek a readjustment of an earlier return, but who subsequently before the statutory period has run, acquires knowledge of this right, and thereafter gives the Commissioner an adequate opportunity to reassess the prior return.

Too, would Judge Hand claim that the Government could not seek to readjust a prior return in the case of a subsequent refund due to the collection of an illegal tax unless the Government served the taxpayer with notice of its intention concomitant with the granting of the refund? The answer is obvious. The Circuit Court of Appeals below would undoubtedly take the position that the Government could reassess the earlier return so long as the statute of limitations had not outlawed such reassessment.

Thus it is apparent that to compel the taxpayer seeking a readjustment of the earlier return to bring the refund to the Commissioner's notice as soon as it is received would be extremely unjust to the taxpayer, and conversely, most biased in favor of the Government.

The petitioner also respectfully submits that the Commissioner did in fact receive an adequate opportunity before the statute of limitations had run to readjust the 1935 return.

The petitioner brought the tax refund to the attention of the Commissioner long before the year 1935 was closed by the statute of limitations; indeed, it offered to include it in income for the year 1935. This offer was never accepted by the Commissioner, who insisted that the proper year in which to reflect the refund was 1936. The taxpayer also offered to pay the amount of tax in 1936, but based on the 1935 rates. The Commissioner refused this offer because the 1936 rates were more than twice as high as the 1935 rates. The Commissioner had the power in this case, based on notices and opportunities repeatedly given to the Commissioner by the taxpayer, to reassess the taxpayer for the year 1935. The affidavit of the taxpayer filed with the Commissioner and sworn to on December 14, 1938, which was long before the statute of limitations had barred the year 1935, shows

that this opportunity had been given to the Commissioner. The Court's attention is directed particularly to paragraphs 7, 8, and 9 thereof (R. 42-43, 40).

POINT III.

The Commissioner, before the statutory period has run, should not have the election of reassessing the original tax or including the refund in the later year.

Petitioner calls special attention to relevant decisions which hold that if the statute of limitations has not run, the Commissioner should reassess the prior return (*Inland Products Co.* v. *Blair, Bergan* v. *Commissioner, Leach* v. *Commissioner, Bohemian Breweries, Inc.* v. *Commissioner, E. B. Elliott Co.* v. *Commissioner, supra*).

Thus Judge Learned Hand's statement that the Commissioner, before the statutory period has expired, may at his pleasure either reassess the original tax or include the refund in the income for the later year (R. 36) is not sustained by any of the cases. To give the Commissioner such an election would be grossly unfair to the taxpayer, for the commissioner would always select the year with the *higher rates.* There would be no tax certainty nor equity in such a rule.

For example, in the *Inland Products Co.* case, *supra,* the Commissioner sought to readjust the prior returns for the years 1919 and 1920, although the refund was made in the year 1924, since there would be a larger deficiency due in income and excess profits taxes than if he had declared the refund taxable income in 1924. The court properly sustained the Commissioner on the basis of correction of a mistake since the statutory period had

not prevented a readjustment of the earlier returns. But in the instant case, where again the statute of limitations was no bar to a readjustment, the Commissioner sought and is seeking to have the refund declared taxable income in 1936, instead of 1935, for the 1936 rates were more than double the 1935 rates. Such inequitable and inconsistent action should not be tolerated by the courts. Here, as in the *Inland Products* case, the Commissioner should have readjusted the prior return since the statutory period did not prevent a reassessment; otherwise, the Commissioner would be permitted to follow inconsistent courses and allowed to completely disregard principles of accounting and law at his whim.

It is respectfully submitted that, as Judge Parker pointed out in the *Inland Products Co.* case, *supra*, the present situation deals with the correction of a mistake between the Government and the taxpayer, and the principles to be applied are those applicable to the correction of such mistakes. There is really but one important issue herein involved; namely, whether the taxpayer, after receiving reimbursements of the invalidated A. A. A. taxes may, before the statutory period has expired, readjust the 1935 income tax return to eliminate the expense deduction The issue should on principle and authority be answered affirmatively—that the tax year 1935 should be revised.

Conclusion.

Petitioner respectfully submits the petition for writ of certiorari should be granted, for the Commissioner should have readjusted the original deduction in the 1935 tax return since the statutory period had not expired; and furthermore, the petitioner did in fact give the Commissioner an adequate and sufficient opportunity to re-

adjust the 1935 return before the statute of limitations had run. In addition, the Commissioner, before the statute of limitations has run, should not at his pleasure be permitted either to reassess the original tax or include the refund in the income for the later year.

Respectfully submitted,

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